

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

HODELL-NATCO INDUSTRIES, Case No. 1:08CV2755
INC., Cleveland, Ohio
Plaintiff, Monday, August 16, 2010
9:30 a.m.

-vs-

SAP AMERICA, INC., et al.

Defendants.

TRANSCRIPT OF ORAL ARGUMENT
BEFORE THE HONORABLE GREG WHITE
UNITED STATES MAGISTRATE JUDGE

APPEARANCES:

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Also Present: Rafael P. McLaughlin

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P R O C E E D I N G S

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THE CLERK: Your Honor, the case before the Court carries case 1:CV2755, Hodell-Natco Industries versus SAP America, et al.

THE COURT: Could we have counsel for the plaintiff enter an appearance on the record, please?

MR. KOEHLER: Wes Lambert and Jim Koehler for Hodell-Natco.

THE COURT: And for the Defendants?

MR. MILLER: Good morning, Your Honor. Michael Miller for SAP America and SAPAG, and I'm joined by my colleague.

MR. ZEPP: Charles Zepp from Porter, Wright.

THE COURT: Mr. Zepp, welcome. And I understand we have Mr. McLaughlin here for LSI-Lowery Systems?

MR. McLAUGHLIN: That's correct.

THE COURT: We had some discussion in chambers on how to proceed here this morning, and I'm going to turn it over to counsel for defendant. They have a Power Point presentation, I understand.

MR. MILLER: Thank you, Your Honor. First, a couple preliminary points. I understand from our conversation that you have read the briefs, you are up

1 to date on the background and the allegations, I'll
2 skip over that, although we may circle back to it, and
3 I made the point in chambers that although we believe
4 Pennsylvania law applies for purposes of today's
5 argument and this motion, we're going to assume that
6 Ohio law applies. We think it is very similar to
7 Pennsylvania, about the same result.

8 THE COURT: Thank you.

9 MR. MILLER: Also, a point about the
10 complexity and confusion.

11 I do think this case is a straight-up breach
12 of contract case. It is Hodell-Natco versus SAP
13 America on the license agreement, not SAPAG, and no
14 tort claims. But there are provisions in the contract
15 that are a real issue for Hodell, and to get around
16 those, they have sought to expand the contractual
17 relationship and inject these tort claims into the
18 case, and it has added complexity.

19 I'll come back to this, Your Honor, but what
20 we are effectively trying to do -- what they are trying
21 to effectively do here is a put a square peg in a round
22 hole, and the complexity and confusion that we're
23 seeing is what results when you try to do that.

24 As we mentioned, I am going to proceed with
25 an argument that tracks Your Honor's questions. Your

1 Honor's first question was ostensibly can the SAP
2 defendants be liable under the 2004 development
3 agreement, and the short answer to that, Your Honor, is
4 no, and there is a simple reason, and a bit of a more
5 complex reason.

6 I'm going to start with the simple reason.
7 Neither of the SAP entities are parties to the 2004
8 development agreement. This is it here. It is the
9 front page of it, anyway. There are the parties. It
10 is Hodell and IBIS and LSI, and I typically refer to
11 IBIS and LSI as just LSI.

12 THE COURT: I will do the same.

13 MR. MILLER: And there was discussion in
14 chambers here, shouldn't there be discovery? You don't
15 need discovery on this. These are the parties to the
16 contract. Let's see who signed it. Hodell and LSI.
17 There is no SAP America and no SAPAG, and that's the
18 simple reason.

19 Then here in bullet two is the more complex
20 reason. Hodell argues that number one, SAP America and
21 SAPAG are intended third parties under the 2004
22 development agreement. They are not. This case cited
23 here is the *Hill versus Sonitrol* case, it is Ohio
24 Supreme Court. It sets forth the standard under Ohio
25 law for an intended third party beneficiary. It adopts

1 Section 302 of the restated section of contracts, which
2 kind of goes on and on, it has various subsections, but
3 here is the key: You cannot proceed, you cannot be an
4 intended third party beneficiary unless you have
5 enforceable rights under the agreement. In other
6 words, you have a right to sue.

7 And if you look, Your Honor, at the
8 development agreement, there is nothing in this
9 development agreement that even hints at the idea that
10 maybe SAP could sue. If Hodell breached the
11 development agreement, the idea that SAP could sue
12 Hodell for Hodell's breach of its contract with LSI
13 doesn't make any sense. If we tried that, we would get
14 bounced right out of Court.

15 THE COURT: You could not enforce the 80
16 licenses, the agreement to buy 80 license in Business
17 One?

18 MR. MILLER: Right. If they didn't buy 80
19 licenses, then tough luck for us. We might have a
20 claim against LSI, we have a contract with them, but if
21 Hodell -- whatever obligations it had to LSI in this
22 contract that I just had up there, if they breached it,
23 SAP had no, no right to sue. They just stand by and
24 hope that it works out.

25 THE COURT: I don't want to get ahead of you,

1 but doesn't the contract contemplate some performance
2 by SAP?

3 MR. MILLER: It has one line in it, Your
4 Honor, towards the end, about if LSI becomes insolvent
5 then SAP will sell certain licenses to the parties, and
6 call that what you want. Confirmation of a verbal
7 agreement; call it a one sentence contract. But it
8 doesn't make SAP a party to all of what you see here.
9 It just --

10 THE COURT: But agency would.

11 MR. MILLER: Well, let's talk about agency,
12 if I don't get too bollixed up here.

13 THE COURT: I just think that that clause
14 about SAP's responsibilities, potential performance
15 under that contract kind of plays into the agency
16 argument, so I would like to hear your response to
17 that.

18 MR. MILLER: Okay. For purposes of agency,
19 let's assume all their allegations are correct, and I
20 have that -- let me just, so we don't miss this, this
21 last item, they cite the *Resource Title* case that not
22 only is an SAP an intended third party beneficiary, but
23 third party beneficiaries can be sued; I'm prepared to
24 come back to that, but it is highly distinguishable.

25 Agency. Right. Number one, Your Honor,

1 there are no cases that stand for the proposition that
2 if one party is an agent of the other, it changes the
3 identity of the contract.

4 Think about an insurance policy, all right?
5 I buy an insurance policy from whoever, Nationwide
6 Insurance, that's where I have my car insurance.

7 I don't sue my agent for breach -- it is a
8 little bit in the reverse, you know what I mean, but I
9 don't sue my agent for breach of my insurance contract.
10 He is not a party to that. I might have a claim
11 against him of some sort, and there are various types
12 of agency-related claims, but number one, the fact --
13 and let's assume for purposes of argument that LSI was
14 SAP's agent. That does not change the identity of the
15 parties to the 2004 development agreement. It LSI and
16 Hodell. The rest of the agency argument, they have
17 no -- there is no real actual authority, allegations in
18 the complaint. There are some, what I call parent
19 authority allegations in the complaint. They are very
20 conclusory, and they never get around, Your Honor,
21 this -- forgive me for going back and forth with my
22 glasses, but you I cannot see the screen without the
23 glasses, and it drives me nuts to have to wear them --
24 but, not the agent. No authority to bind or make
25 representations or warranties. So, for me --

1 THE COURT: That's the licensing agreement.

2 MR. MILLER: That's right. That they
3 executed. That's our contract with them. And you
4 asked, Your Honor, what effect should the license
5 agreement have on the 2004 development agreement.

6 I don't know if I have a copy on the Power
7 Point of the license agreement, but it is very simple.
8 It is all the way at the end. Entire agreement. It
9 would be easier to read it from here. It might be up
10 here.

11 "This agreement and each schedule and
12 appendix hereto constitute the complete and exclusive
13 statement of the agreement between SAP and licensee,"
14 that's Hodell, "and all previous representations,
15 discussions and writings" -- that would be the
16 development agreement -- "are merged in and
17 superseded" --

18 THE COURT: Why would that be the development
19 agreement? I don't understand why you can't have two
20 contracts.

21 MR. MILLER: My point is -- well, we might
22 have. If the development agreement was drafted
23 differently, and it was between Hodell on the one hand
24 and LSI and SAP on the other hand and we all signed it,
25 then that might be, but we didn't do that.

1 I'm assuming just for the purposes of
2 argument, even if we had -- first, we didn't do that,
3 but even if we had done that and then we executed the
4 license agreement with Hodell --

5 THE COURT: You think, then, the license
6 agreement is going to swallow up the development
7 agreement?

8 MR. MILLER: Parties do that all the time,
9 Your Honor. They can have a series of contracts going
10 back years, going back generations. The contract that
11 exists at the moment is the one they consciously and
12 intentionally entered into, and if they put in there
13 that this is their sole agreement, forget what happened
14 before, here is our deal going forward, then they have
15 one contract, and that's it, and that's what happened
16 here.

17 THE COURT: Well, you know, okay. I hear
18 you. I don't know.

19 MR. MILLER: I appreciate that. I don't mind
20 spending time on it. For me --

21 THE COURT: That's the crux of your argument.
22 I mean, if the licensing agreement doesn't control the
23 development agreement, if they are not considered two
24 separate and enforceable contracts, that is your
25 argument, in essence.

1 MR. MILLER: Your Honor, I find myself --
2 some of this, to me, you're never going to find cases
3 for, because the propositions are, to me, very obvious
4 and very simple. We were not a party to the
5 development agreement. You can't find our name on it.
6 The agency allegations don't change the identity of the
7 parties, and that disclosed principal issue is also a
8 complete red herring. Disclosed principal is when an
9 agent wants to absolve itself for liability in a
10 contract, and it is basically arguing, oh, I'm not the
11 party to this contract, my principal is.

12 In this case, LSI is the party to the
13 contract. We saw its name right up there on the
14 signature line, and Hodell acknowledges that when they
15 sue LSI on the contract. We're not a party to --

16 THE COURT: And once again, we have to accept
17 the allegation in the complaint as true, right? They
18 have alleged agency; LSI has admitted that they were
19 your agent in the development agreement --

20 MR. MILLER: And if, for example, that
21 contract -- Your Honor, we have an interpretive
22 contract. The first thing we look at is the language.
23 We are looking at the parties' intent. If it was the
24 intention of the parties that SAP was going to be a
25 party because its agent, LSI, made it a party, that

1 intention would be clearly and plainly expressed in the
2 very first sentence, when it says here is who the
3 parties are, and it would be at the end, too, because
4 someone would sign on behalf of SAP. It might even be
5 LSI.

6 THE COURT: So you don't think any of the
7 representations that SAP made in regard to the
8 capabilities of their Business One software had
9 anything to do with the execution of the development
10 agreement?

11 MR. MILLER: They may or may not have. To
12 me, it is not relevant for purposes of whether they can
13 proceed on a breach of contract claim on the
14 development agreement.

15 THE COURT: I get the breach of contract, and
16 we are kind of mixing those up --

17 MR. MILLER: I understand. That's a great
18 point. Could SAP have made some representations that
19 induced, right, Hodell to enter into the development
20 agreement, and they have some of the flavor of that
21 allegation in the complaint, and my response to that is
22 it doesn't change the result in this case, because you
23 get to the license agreement next, because there is a
24 contract, a very sophisticated commercial contract
25 between SAP and Hodell. It was entered into in

1 December of 2005. Even if we had been a party to the
2 2004 development agreement, all of that is wiped clean,
3 and now you --

4 THE COURT: Well, that's a central question
5 to me. And I guess -- I hear you say it, but --

6 MR. MILLER: But, Your Honor, that is
7 business. If Your Honor and I had some sort of
8 contractual relationship, I was your tenant, you know,
9 and we had an agreement one year, an agreement another
10 year, you know, and then --

11 THE COURT: Well, let's try to stick to the
12 facts here. I mean, they are alleging in their
13 complaint -- again, this is a 12(b)(6) motion to
14 dismiss, they are alleging in the complaint that the
15 only reason they entered into the development agreement
16 was because of the representations that SAP made
17 regarding the capabilities of their software.

18 MR. MILLER: Understood, and the question is
19 might they have a tort claim, right?

20 Let's leave aside the whole breach of
21 contract claim, and that's why I go straight to the
22 license agreement, Your Honor, is because the facts of
23 this case are that in December of 2005, not long after
24 they entered into that development agreement and prior
25 to when these claims developed, they entered into a

1 contract with SAP that said, number one, we're not
2 going to ever seek certain damages for you, and number
3 two, under the Ohio economic loss rule, it precludes
4 them from bringing tort claims.

5 THE COURT: And I hear you saying that -- I
6 get your argument, that the licensing agreement is the
7 total agreement between you and Hodell. I get that.

8 MR. MILLER: Is it Hodell?

9 MR. LAMBERT: Hodell, yes.

10 MR. MILLER: I have been going with Hodell.
11 But that is very significant commercial reality, and it
12 ends up, Your Honor, if you'll permit me -- breach of
13 contract, right? Just to spare us coming back to this.
14 This is the license agreement, that's who the parties
15 were, and this is a very important point. It relates
16 to what Your Honor is raising. What kind of claims do
17 we have here, and what we really have, Your Honor, are
18 breach of contract claims.

19 The second bullet, okay, what they
20 effectively claim is that oh, the software didn't work.
21 It failed to function. It didn't conform to the
22 functional specifications contained in the
23 documentation.

24 This is their complaint right here --

25 THE COURT: Well, you're not arguing, are

1 you, and I didn't read in any of your briefs that you
2 are disputing that the Business One software can handle
3 no more than 30 users.

4 MR. MILLER: We're not conceding anything,
5 Your Honor --

6 THE COURT: You have not argued against that.

7 MR. MILLER: Correct. They have a breach of
8 contract claim that they can proceed with against SAP
9 America --

10 THE COURT: So your current position, as I
11 understand it, is that it cannot handle more than 30
12 users?

13 MR. MILLER: That it cannot?

14 THE COURT: Yes.

15 MR. MILLER: No. I understand it is actually
16 not the users that matter so much, it is the number of
17 transactions.

18 You could have -- I don't know the technical
19 pieces, so I don't want to get too far ahead, but you
20 can have many users, you can have 200 users with the
21 Business One software. It depends how many
22 transactions each one of those people are doing.

23 Now, I understand in the Hodell context, they
24 had like 160,000 products, and it sounds like that
25 might at the end of the day be one of the significant

1 issues in this case, you know --

2 THE COURT: The complaint phrases it in --

3 MR. MILLER: It's a combination of how many
4 users you have, how many transactions you have. We
5 have not contested any of that for the purposes of
6 today's motion. I'm not conceding any of it; I have to
7 learn some of the technical issues, frankly, and
8 address them then, but we don't --

9 THE COURT: But that's the context of the
10 complaint. We are dealing with, again, a 12(b)(6)
11 motion.

12 MR. MILLER: Absolutely, but in the 12(b)(6)
13 context, the economic loss rule gets applied, and there
14 are cases dismissing fraudulent inducement claims in
15 the 12(b)(6) context.

16 In the software context, where it is
17 fraudulent inducement, and one of the keys is exactly,
18 Your Honor, what I'm showing here, which is, okay, what
19 is this case all about? Is this really a contract
20 case, or is this really a tort case?

21 And under Ohio law, it is very confusing, I
22 know, there are lots of cases and they go all over the
23 place, but when the parties are in contract together,
24 when they are in privity, Ohio law is distilled down to
25 basically having two requirements if you want to try

1 and have tort claims in addition to your breach of
2 contract claims. You have to show that there is a
3 contractual duty -- pardon me --

4 THE COURT: A duty outside the contract.

5 MR. MILLER: Right. Separate and distinct
6 from what's in the contract, and damages that are
7 separate and distinct from breach of contract damages,
8 and the reason, Your Honor this --

9 THE COURT: Well, I thought the fraudulent
10 inducement law in Ohio was that if they can establish
11 that, they get all the proximate damages.

12 MR. MILLER: No. Look at *Medical Billing*,
13 for example. Sixth Circuit, I think it is 2007 or
14 2005, it's a fraudulent inducement count. It actually
15 went to trial, and when they realized that the damages
16 for fraudulent inducement were no different than the
17 breach of contract damages, they cut the fraudulent
18 inducement piece out of the case all together.

19 And that is -- and the analysis, Your Honor,
20 in *Medical Billing*, Sixth Circuit, applying Ohio law,
21 was this: What's their case about? Is it about tort
22 stuff, or is it really tort stuff recast, or breach of
23 contract recast as tort?

24 Look at the first paragraph of the complaint.
25 "Injuries sustained from the sale." When you go

1 through their complaint, all of it -- this is just that
2 it didn't work, right -- all of it is really breach of
3 contract in disguise, and the piece of the contract
4 that they are saying was breached is right here. 7.1.
5 What they say is SAP breached its warranty. We
6 warranted that it would work for you.

7 THE COURT: You kind of conceded that in a
8 footnote, didn't you?

9 MR. MILLER: Yes. And I did two minutes ago,
10 that they can proceed with a breach of contract claim
11 against SAP America, and it is --

12 THE COURT: Under the licensing agreement.

13 MR. MILLER: Based on the licensing
14 agreement, and it is based on this promise that we made
15 to them, that the software would work for them, and
16 when you read their complaint, even in their tort claim
17 contexts, what they are effectively saying is you
18 didn't do that.

19 And the reason that's a problem -- I'll skip
20 ahead, this is just, you know, there are not other
21 warranties, there are not implied warranties, SAPAG is
22 not liable for warranties -- I'll come back to damages.

23 Economic loss rule, right? The duty and the
24 damages. And there is the duty, all the duty -- I'm
25 going to skip over there and go right to damages --

1 THE COURT: You are saying they have alleged
2 no duty outside the contract in any count in the
3 complaint?

4 MR. MILLER: I think that of two
5 requirements, that was the tougher one for SAP to get
6 over. I think there is some confusion in the cases.

7 Occasionally, for example, in the *Forum* case,
8 Your Honor, that you pulled out today, it was a great
9 read for me, and I'm sure for counsel.

10 What is in here, right? Well, number one, I
11 notice right away there is no privity. Number two, no
12 one raised economic loss rule in that case. And that
13 happens. We have cases where, you know, each one
14 proceeds in a different procedural sequence --

15 THE COURT: I think we gave you some case law
16 for fraudulent inducement and economic loss in Ohio.

17 MR. MILLER: *Onyx*, no privity; *Marine Direct*
18 supports our position. And *Marine Direct*, the only
19 reason the parties were allowed to proceed with the
20 fraudulent inducement count is, and it is right in the
21 last sentence of the case, they say the damages look
22 like they are different.

23 THE COURT: Well, I read that as saying where
24 fraud and contract duties are distinct from one
25 another, the economic loss doctrine is not a bar to the

1 fraud claim.

2 MR. MILLER: Pardon, Your Honor?

3 THE COURT: *Marine Direct*. Where a fraud --

4 MR. MILLER: I could not hear you.

5 THE COURT: I said where fraud and contract
6 duties are distinct from one other, the economic loss
7 doctrine is not a bar to the fraud claim.

8 MR. MILLER: In *Marine Direct* -- there are
9 two requirements. That is one of them. That was the
10 duty requirement, but if you go back to this, right,
11 that is number one. And *Marine Direct* does have
12 language in there about that, and as I pointed out to
13 Your Honor, I think of the two separate and distinct
14 requirements, duty is tougher for SAP to deal with, and
15 that's why I made that point. Sometimes it come up,
16 sometimes it doesn't.

17 There are some cases in there where
18 fraudulent inducement -- take *Galmish*, for example.
19 *Galmish* is one of the cases we argued over in the parol
20 evidence context. It is a fraudulent inducement count.
21 You look at it and you go, "Huh? Where is the economic
22 loss analysis?" And it is not in there. And from that
23 you must being to go, well maybe there is a duty
24 exception for fraudulent inducement, but is there a
25 damages exception, and when you read the cases, they

1 say no, and *Marine Direct*, Your Honor, is one of them,
2 and *Marine Direct* says two things, right at the end of
3 the opinion.

4 Actually, the last sentence is probably the
5 best summary. Although *Marine Direct* may not directly
6 recover the unpaid commissions based on a tort theory,
7 if it can prove fraudulent inducement of the contract,
8 it can be entitled to whatever amount of damages is
9 proximately caused. They have to prove separate and
10 distinct damages, and when you look, Your Honor, at the
11 damages in this case, here is what they say: They are
12 all from the sale, all the injuries are from the sale.
13 These are the sentences they have right at the end of
14 every one of their counts. They are basically
15 identical -- oh, I messed it up.

16 There are two paragraphs. They seek direct
17 damages and they seek indirect damages. Their
18 breach -- the case is basically a breach of contract
19 action. The damages that they seek are basically
20 breach of contract damages, and you can -- I'll give
21 Your Honor a copy of this and you can see, every time
22 they ask for damages, it is basically the same as the
23 breach of contract damages, and -- and this is
24 important -- when you look at the kinds of damages that
25 you are entitled to under Ohio law, it is very broad.

1 This is damages limitations, right? But this case
2 right here, *National Mulch and Seed*, okay, this is a
3 UCC case. And if you look in the UCC, they are
4 entitled to be made whole. If their breach of contract
5 claim under the license agreement against SAP America
6 turns out to have merit, they can collect a lot of
7 significant -- the UCC provides them with a very broad
8 range of damages and this case, *National Mulch and*
9 *Seed*, does a pretty good job of describing what they
10 are, and those damages include consequential damages
11 and incidental damages, which are the same as the
12 indirect damages, the direct and indirect damages they
13 are seeking in the complaint.

14 So when you go through this analysis, you
15 have a situation where this is fundamentally a breach
16 of contract case. They are saying it doesn't work.
17 Okay. But are they alleging any separate damages?
18 Because, you know, if they do that, then maybe they can
19 proceed with this economic -- you know, despite the
20 existence of the economic loss, or maybe they can
21 proceed with the fraudulent inducement count, but when
22 you read their complaint, in all fairness, they don't
23 allege any different damages claims. They just are
24 seeking to be made whole under the breach of contract
25 claim, and they are entitled to be made whole under the

1 UCC, which Ohio's version gives them all sorts of
2 damages, including consequential damages, including
3 incidental damages, but there is nothing in the
4 complaint that says "Oh, and this is different." The
5 only exception is one line where they say punitive
6 damages, right? But punitive damages -- I mean, if
7 that was the rule, that's how you get around economic
8 loss every time. You always ask for punitive damages.
9 And there is no kind of reasoning that supports that.

10 The point is, under Ohio -- and this string,
11 Your Honor, of cases, every one of these is Ohio law,
12 where the Court is talking about the damages
13 requirement. The separate and distinct damages
14 requirement. They are in chronological order. Supreme
15 Court, Sixth Circuit, and recent district cases,
16 including fraud and including fraudulent inducement
17 cases, and there have been, Your Honor, I cited right
18 at the end of this, this *Irwin Seating* case, that is a
19 motion to dismiss granted, it's Sixth Circuit, it is
20 Michigan law, which is comparable to Ohio. It is a
21 software case. Motion to dismiss, fraudulent
22 inducement, dismissed on economic loss rule grounds
23 because of exactly what I'm saying.

24 They are basically alleging damages -- they
25 are trying to get damages for their tort claims that

1 are basically breach of contract, and they are already
2 entitled to those.

3 The last piece, and this is why --

4 THE COURT: Was that a summary judgment or a
5 12(b)(6)?

6 MR. MILLER: 12(b)(6). Sixth Circuit.

7 The reason that we're trying to put -- we're
8 in this square peg in a round hole situation is this:
9 Contract damages under the UCC would be great for them,
10 but they signed a contract that said they are going to
11 limit those damages, and they are trying to avoid it.
12 They don't argue in their brief that this doesn't
13 apply. There is very little commentary. This is very
14 broad. Sole and exclusive remedy, damages or losses in
15 any way, due to negligence or breach of any duty, which
16 can't be stated any more broadly than that. It is
17 impossible to say it more broadly. And there are two
18 of them. There is 9.1 and 9.2.

19 THE COURT: I understand what the licensing
20 agreement says, and that takes us back to our other
21 questions about the impact that has on the development
22 agreement, but there is no question here from a
23 12(b)(6) standpoint, and without, again, getting into
24 the issues that you just raised in terms of fraudulent
25 inducement, but there is no question that the parties

1 to the licensing agreement at least contemplated that
2 your Business One software could handle 120 users.

3 MR. MILLER: Absolutely.

4 THE COURT: And the contemplation in the
5 development agreement that it could handle at least 80
6 users. You may not have been -- you are claiming you
7 are not a party to that, but there is no question that
8 the development agreement contemplated that Business
9 One software could handle 80 users, and for the
10 purposes of this motion, we have to believe that it
11 can't.

12 MR. MILLER: That sounds true.

13 THE COURT: Okay.

14 MR. MILLER: I will confess to you standing
15 here, I don't remember where that is in the development
16 agreement.

17 THE COURT: Well, there were 80 licenses
18 being sold in the development agreement.

19 MR. MILLER: That may be some implied piece
20 of that, I understand, you know. This is a case that
21 has --

22 THE COURT: And we have to accept for this
23 purpose that it couldn't handle 80, let alone 120.

24 MR. MILLER: Well, we have to accept, Your
25 Honor --

1 THE COURT: For the 12(b)(6).

2 MR. MILLER: That they have alleged that,
3 agreed, and for purposes of this motion, that is
4 assumed to be true.

5 THE COURT: Right.

6 MR. MILLER: Exactly. I think I'll close,
7 because I know we have a lot more to do.

8 This is a case that is complex standing here
9 right now, and can get more complex, but it is a
10 case --

11 THE COURT: Do you think I'm making it more
12 complex?

13 MR. MILLER: Not at all.

14 THE COURT: I just want to know the answer to
15 that.

16 MR. MILLER: Your Honor, these are really
17 interesting cases. This is, you know, sometimes I go
18 down to the library, get the remedies book out --

19 THE COURT: This is law school stuff.

20 MR. MILLER: A little bit like that. And
21 Your Honor, two or three times standing here, I bit my
22 tongue, but I will proceed.

23 To me, when you come to the breach of
24 contract stuff, it is law school. And if you write
25 down in your answer that SAP is a party to this

1 development agreement or that SAP is a third party
2 beneficiary or that SAP is a --

3 THE COURT: Do you have to be a party to
4 fraudulently induce it?

5 MR. MILLER: No, you do not. I understand
6 that point. And Your Honor raised that question, and I
7 conceded that in the beginning.

8 THE COURT: Right. So wouldn't you be
9 responsible for fraudulent inducement, even though you
10 are not a party? Set aside the licensing agreement for
11 a second.

12 MR. MILLER: Understood.

13 THE COURT: So for purposes of the 12(b)(6),
14 if we didn't have the licensing agreement, you would
15 be -- you would be responsible for conceding all these
16 points, that your Business One can't handle that number
17 of users, that you would be responsible for the
18 fraudulent inducement of that contract.

19 MR. MILLER: I think that if we never had the
20 license agreement, I think they made agency allegations
21 that LSI is acting on our behalf and made all these
22 representations, and we were induced in there.

23 THE COURT: So we get past the 12(b)(6).

24 MR. MILLER: And I can see that we go to here
25 is a licensing agreement, and this is what it said,

1 that you are not our agent, and here are the terms and
2 everything else is wiped clear, and you won't sue us
3 for damages, and the economic loss rule applies because
4 we're now in privity. And that's how we get to where
5 we are.

6 THE COURT: Okay.

7 MR. MILLER: Thank you, Your Honor.

8 THE COURT: All right. Mr. Lambert.

9 MR. LAMBERT: Your Honor, I'm going to use
10 the podium, because I have a variety of stuff I have to
11 refer to.

12 I think from Hodell's standpoint, we have to
13 at least understand my perspective on the contractual
14 arrangement and the transactional structure, at least
15 as far as I'm aware of it at the pre-discovery stage.

16 The software that SAP sold Hodell-Natco to my
17 understanding wasn't -- and I think it is contained in
18 the license agreement, wasn't independently functional,
19 it had to be integrated with other software, and
20 because of that fact, you have the development
21 agreement, which contemplates the development of other
22 software to be used along with --

23 THE COURT: From LSI, and you were going to
24 get a benefit from doing that as well, right?

25 MR. LAMBERT: Correct, which we never did,

1 but that's beside the point.

2 So when we're talking about whether we have
3 just a straight-up breach of contract action for the
4 sale of SAP Business One licenses --

5 THE COURT: And I want to talk about the
6 timing of the sale of the licenses a little bit,
7 because I had some questions of you about that --

8 MR. LAMBERT: Sure.

9 THE COURT: Because the development
10 contemplates -- here is my global assessment of what
11 was happening in the development agreement.

12 You guys hired LSI to come in, take a look at
13 the software you were using, bring in some software
14 they had outside of Business One, look at your business
15 model, go around and talk to all your people, you know,
16 what would work for you, what would make your job
17 easier, what would make us integrate all of our parts
18 and pieces, and they were going to work on that for a
19 while before they attempted to integrate Business One
20 into that system.

21 Am I wrong about that?

22 MR. LAMBERT: I don't think that is exactly
23 how it worked. I think how it worked was --

24 MR. KOEHLER: I think you are pretty close.

25 THE COURT: Because the development agreement

1 contemplates that you were not even going to get the
2 Business One software for 300 days after you signed the
3 development agreement, right, and because the first --
4 the last \$120,000 of the money paid under the
5 development agreement was actually going to be
6 purchasing Business One software.

7 MR. LAMBERT: Correct.

8 THE COURT: And the first \$180,000 was
9 basically the fees for LSI to come in there and figure
10 out what they needed to do to make your software and
11 their software and Business One work together, so you
12 really were not getting Business One for almost a year,
13 which would be about the time you signed the licensing
14 agreement, after you signed the development agreement.

15 Isn't that what the contract says?

16 MR. LAMBERT: Yes. The contract says that
17 SAP, Business One, is being purchased in the context of
18 this overall transaction --

19 THE COURT: I get that, but you were not
20 going to get Business One itself, the product, Business
21 One, for a year after you signed that contract.

22 MR. LAMBERT: I don't think it is relevant
23 when I got it. It is when I committed myself to buy
24 it.

25 THE COURT: Well, it is relevant when you got

1 it, because when you get it, you have to sign the
2 licensing agreement.

3 MR. LAMBERT: I didn't sign the licensing
4 agreement with respect to what was recommended to me to
5 be --

6 THE COURT: I understand the representations.
7 I'm talking about when you actually got Business One on
8 your system.

9 MR. LAMBERT: I think that's a fact that has
10 to be developed through discovery. I think we had it
11 in our possession before this license agreement came
12 into play.

13 THE COURT: I wondered about that, just
14 because of the terms of the contract, you know. It is
15 clear that when LSI sells something under their
16 agreement with SAP, they may sell a Business One, they
17 have to make you sign this license agreement.

18 Now, you're saying they didn't when they gave
19 you the first 80 copies --

20 MR. LAMBERT: That's correct.

21 THE COURT: User licenses, but your own
22 contract says 300 days before we are even going to buy
23 Business One, so I'm curious about how that plays into
24 your saying that you already had 80 copies, 80 licenses
25 before you signed the licensing agreement, and they

1 would not give you the other 40 until you signed the
2 licensing agreement, so, you know, I wonder about that.

3 MR. LAMBERT: Well, I'll tell you what to me
4 seems kind of odd about the whole transaction is that
5 it is my understanding the second 40 were actually
6 offered, I could be wrong -- well, no. As we allege,
7 it was offered pursuant to a one-time limited offer --

8 THE COURT: In the development agreement.

9 MR. LAMBERT: I think you might find through
10 discovery that maybe they realized there was an error
11 in not having us sign the license agreement with regard
12 to the first 80, and then say, oh, you know, we have to
13 pitch this one-time limited offer, and get the other 40
14 in 2005, have them execute the license agreement, and
15 that way we roped them in, maybe we can have it apply
16 retroactively, but when you talk about the license
17 agreement specifically, it can't apply retroactively.
18 So, again --

19 THE COURT: So I guess I would like you to
20 address the point that Mr. Miller was making about the
21 relationship the licensing agreement has to the
22 development agreement.

23 MR. LAMBERT: Okay. It has absolutely no
24 relationship, according to its own terms. If you
25 look --

1 THE COURT: Because that's kind of a critical
2 question here. Aside from your allegations that you
3 were fraudulently induced to sign the licensing
4 agreement, if the development agreement stands on its
5 own, there is no choice of law, there is no limit of
6 liability, there is no waiver of warranties. That is
7 your position?

8 MR. LAMBERT: Theoretically, if I'm wrong on
9 some of these issues, the Court would have to apply
10 Ohio law with regard to the 2004 transaction, and
11 Pennsylvania law with regard to the 2005 transaction.

12 THE COURT: If they are separate. If they
13 are separate.

14 MR. LAMBERT: If they are separate, and if
15 I'm correct that this agreement was fraudulently
16 induced.

17 THE COURT: But you still think you get your
18 whole damages under the development agreement breach?

19 MR. LAMBERT: Absolutely.

20 THE COURT: So you don't even need the
21 licensing agreement breach.

22 MR. LAMBERT: With regard to the fraudulent
23 inducement allegations, I think it is -- that is for me
24 two separate transactions. At worse, maybe an
25 integrated transaction --

1 THE COURT: So how can it be a no-brainer on
2 both sides? The licensing agreement kind of is a --
3 takes over the whole understanding between you and SAP,
4 and you are saying no-brainer, they are two different
5 contracts, two separate contracts, separately
6 enforceable? How do I resolve that?

7 MR. LAMBERT: I think you let us have
8 discovery and hear from representatives of LSI and
9 IBIS.

10 THE COURT: Well, LSI basically has taken
11 your side on this.

12 MR. LAMBERT: And they are very wise for
13 doing so. But whether the license agreement applies to
14 the development agreement, if you look at the -- for
15 example, the definition of the term "software," as used
16 in the license agreement, applies to -- pursuant to the
17 order for the software, including present and future
18 orders placed by the licensee. It does not apply to
19 prior orders, okay?

20 If you look at the term of the agreement,
21 "this agreement and the license agreement granted
22 hereunder shall become effective as of the date first
23 set forth above," which is December, 2005. So how
24 could it apply? It wasn't effective when we purchased
25 the first 80.

1 THE COURT: But that goes back to my question
2 about when you actually got the first 80 Business One
3 licenses. But that, I guess that's beside the point
4 for purposes of this argument.

5 MR. LAMBERT: Correct. And for purposes of
6 this argument --

7 THE COURT: And waiving the agency, you're
8 saying, okay, if we waive the agency in the license
9 agreement, saying LSI is not an agent, that has nothing
10 to do -- we're not saying they were not an agent for
11 the development agreement.

12 MR. LAMBERT: Correct, or if I was
13 fraudulently induced into signing the agreement under
14 the auspices of a one-time limited offer when they
15 realized we hadn't signed it for the first 80, then
16 none of this stuff is applicable.

17 And importantly, especially for purposes of
18 this motion and I think throughout the case, SAP
19 drafted this agreement, it looks to me to be a form
20 agreement, it has to be construed against SAP as the
21 drafter. If they wanted this to apply to prior
22 transactions, and I realize there is the merger clause
23 in there, but if there are two separate transactions,
24 right, two separate agreements, then --

25 THE COURT: Well, the development

1 agreement --

2 MR. LAMBERT: -- it is expressly stated in
3 the license agreement it applied to the first 80.

4 THE COURT: So I hear your argument being the
5 license agreement at best applies only to the Business
6 One software, and the development agreement is much
7 broader than that because it involves the development
8 and the integration of your existing software with
9 Business One, as well as the software that LSI is
10 bringing to the table.

11 MR. LAMBERT: Correct. And if we were to get
12 down to brass tacks, I don't even think that I have to
13 prove that SAP was a party to the development
14 agreement. I don't think there will be any dispute
15 that they sold Hodell-Natco 80 licenses of Business One
16 software in 2004 through their agent -- maybe the
17 agency aspect will be disputed, but through LSI --

18 THE COURT: Well, is agency your stronger
19 argument, or third party beneficiary?

20 MR. LAMBERT: Right now I don't know. I
21 think they are both on equal footing.

22 THE COURT: Really.

23 MR. LAMBERT: In the development agreement --
24 if I have to prove that they are a party to the
25 development agreement, it expressly contemplates the

1 performance by SAP in there.

2 THE COURT: But they didn't agree to that
3 performance.

4 MR. LAMBERT: Well, then, they can't cast
5 channel partners out into the business world to act as
6 their agents and have them make representations about
7 their product, enter into the sale of their products
8 with business entities, and then say "Well, I didn't
9 read any of that, you know, those were not my
10 representations" --

11 THE COURT: So you think that SAP could have
12 forced you to buy the 80 licenses if you chose not to
13 halfway through that deal?

14 MR. LAMBERT: That's a good question.

15 THE COURT: Yes.

16 MR. LAMBERT: I think it is arguable that
17 they could have, yes.

18 THE COURT: Really. Okay.

19 MR. LAMBERT: I think if everything had gone
20 according to plan, Your Honor, and everything had
21 worked --

22 THE COURT: No question SAP was going to get
23 a benefit out of the development agreement.

24 MR. LAMBERT: They were going to get the
25 purchase price.

1 THE COURT: The sale of the 80 licenses.

2 MR. LAMBERT: Right.

3 THE COURT: But I guess the question related
4 to what enforceability rights did they have in that
5 context.

6 MR. LAMBERT: Well, for example --

7 THE COURT: I see you winning perhaps on the
8 fraudulent inducement question, where for purposes of
9 this 12(b)(6) -- winning, winning the 12(b)(6) because
10 we are conceding that they couldn't handle 80 users
11 when you signed that development agreement --

12 MR. LAMBERT: Not only that they couldn't
13 handle it, but that they knew they couldn't handle even
14 30, and that they -- and that we were going to be
15 purchasing or needing upwards of 300. That's why we
16 went down this path in the first place. We never would
17 have gone down the path --

18 THE COURT: And that's the allegation in the
19 complaint we're accepting as true, but I question
20 whether or not SAP had any right to enforce your
21 agreement with LSI to buy 80 copies of the Business One
22 software.

23 MR. LAMBERT: Correct. And you can
24 contemplate a situation under the development agreement
25 where the SAP Business One software works correctly,

1 the integration with LSI software works; LSI is unable
2 to continue performance under the agreement --

3 THE COURT: Well, that begs the question,
4 though, doesn't it? I mean, why would they sell you
5 120 licenses and work for three years to try to make it
6 work if they knew when they sold it to you it wouldn't
7 work?

8 MR. LAMBERT: I think that they were -- I
9 think they knew -- and again, this is something I'll
10 have to prove through discovery, but I think you could
11 find in discovery that they knew it wasn't capable of
12 working then, but they hoped as they continued to work
13 through the problems with us, maybe something would
14 happen that they would discover, oh, here is what
15 wrong, and they could implement it again.

16 THE COURT: I'm just questioning, it's a
17 legitimate question, what's the motive for a company
18 like SAP to sell you 120 licenses for something that
19 they knew could only handle 30?

20 MR. LAMBERT: I think that -- I think that
21 you could find a situation where they know that in its
22 current state it wouldn't work --

23 THE COURT: Do you have to prove they knew
24 it?

25 MR. LAMBERT: I think we're going to have to

1 prove intent. Correct.

2 THE COURT: Okay.

3 MR. KOEHLER: Can I chime in on your
4 question?

5 THE COURT: Sure.

6 MR. KOEHLER: What SAP knew is not
7 necessarily the same thing as LSI knew. LSI was the
8 one that was primarily dealing directly with
9 Hodell-Natco, and at least the documents that I have
10 seen that they are going to come out and discover --

11 THE COURT: Well, they are going to say they
12 didn't know, right?

13 MR. KOEHLER: Exactly.

14 THE COURT: They already said that. But
15 that's back to the agency thing again.

16 MR. KOEHLER: Well, your question was why
17 would these licenses be sold if they didn't know that
18 they couldn't perform; well, it was LSI that was
19 dealing directly --

20 THE COURT: They signed the licensing
21 agreement --

22 MR. KOEHLER: Pardon?

23 THE COURT: They signed the licensing
24 agreement for 120 licenses. SAP did.

25 MR. KOEHLER: I don't know why SAP would do

1 it, but the point I'm making --

2 THE COURT: Well, I understand you're saying
3 LSI would do it because they didn't know.

4 MR. KOEHLER: Right.

5 THE COURT: But my question is why would SAP
6 do it?

7 MR. KOEHLER: Who knows. We'll find out.
8 Maybe it is the right arm not knowing what the left arm
9 is doing. In an organization the size of SAP, I can
10 tell you, that happens all the time, where marketing is
11 not fully conversant with the products they are
12 selling.

13 THE COURT: That's why I passed out that
14 *Magical Farms* case. I'm trying to interpret that, but
15 it seems to me it says you don't have to prove they
16 knew it was false at the time it was made; you have to
17 prove that it was put out with the intention that
18 people would rely upon it, and it turned out to be
19 false. So, that's why I asked the question.

20 If you think you have to prove that they knew
21 it was false at the time it was -- that the
22 representations were made, then that is a big hurdle.
23 That is an intentional, "I'm going to misrepresent this
24 for the purpose of obtaining a contract," and that's
25 where I trip over their motive. I mean, if they are

1 putting it out there and wanting you to rely on it and
2 it turns out to be false, that is a different case,
3 right?

4 MR. LAMBERT: If they were -- if they knew --
5 if they were reckless in not knowing whether the
6 software could support the number of users they were --

7 THE COURT: And that is your allegation in
8 the complaint.

9 MR. LAMBERT: Correct. And we pleaded in the
10 alternative.

11 THE COURT: Okay.

12 MR. LAMBERT: I also, Your Honor, I don't see
13 a reference in the license agreement to 120 licenses.

14 THE COURT: You are claiming that was in the
15 documentation? That is your claim in the complaint.

16 MR. LAMBERT: Okay. But with regard to
17 the --

18 THE COURT: And they are conceding there was
19 an implied warranty of 120 users --

20 MR. MILLER: Your Honor, what we conceded is
21 that there was an express warranty that this software
22 would work for you.

23 THE COURT: Right. For what they were
24 buying. 120 copies.

25 MR. MILLER: Whatever we sell you, 7.1 says

1 this will work for you.

2 THE COURT: And then you have your limitation
3 of damages.

4 MR. LAMBERT: And with regard to the
5 limitation on damages, I don't know that that is even
6 something that should be addressed on the motion to
7 dismiss. It doesn't entitle them to a dismissal for
8 any of the claims. If it comes out through discovery
9 that that is an enforceable clause, we'll address what
10 damages Hodell-Natco can recover for breach of the
11 warranties. I don't think it is enforceable; I don't
12 think it applies to the 2004 transaction, but it's
13 certainly not a basis to dismiss any portion of the
14 complaint.

15 THE COURT: Okay. Let me see if I get this.
16 You feel like the licensing agreement is not
17 even really a part of this, because it was fraudulently
18 induced --

19 MR. LAMBERT: Correct.

20 THE COURT: -- and that you get your whole
21 damages out of the development agreement, which was
22 also fraudulently induced --

23 THE DEFENDANT: Correct.

24 THE COURT: And that they are liable under
25 that on an agency and third party beneficiary theory.

1 MR. LAMBERT: Correct.

2 THE COURT: Okay.

3 MR. LAMBERT: As the seller of the SAP --

4 THE COURT: And you don't think that we
5 should address how much the damages are, or whether you
6 are entitled to punitive damages in a 12(b)(6) motion.

7 MR. LAMBERT: There is no pleading standard
8 for punitive damages. There are allegation in the
9 complaint that if proven could give rise to punitive
10 damages. I don't have to allege that there is malice
11 necessarily, and there is certainly no -- there is
12 certainly no requirement at the pleading stage for
13 Hodell-Natco to have to itemize what damages it
14 suffered, what categories of damages it suffered, and
15 that's what I took SAP's argument to be, is that they
16 have alleged fraudulent inducement, but they have
17 generalized what damages they suffered from that fraud,
18 and they should have had to parse out the category of
19 damages they suffered, how much damages are
20 attributable to the fraud versus what's the breach of
21 contract damages, and that's certainly not an
22 obligation of the pleadings --

23 THE COURT: Okay.

24 MR. LAMBERT: Do you want me to move --

25 THE COURT: I want to try to resolve if we

1 can, from Mr. Miller's standpoint, this issue of, you
2 know, don't you think that the development agreement
3 had a life separate and apart from the licensing
4 agreement.

5 MR. MILLER: It did.

6 THE COURT: Okay.

7 MR. MILLER: It was between LSI --

8 THE COURT: But not with SAP?

9 MR. MILLER: Think about, Your Honor, the
10 first question asked of Hodell's counsel. What was the
11 development agreement really about. It was a business
12 deal. You look at the end of it, they were looking to
13 make money. They were going into partnership together
14 to make a solution for the fastener industry. If it
15 would work for Hodell, they would sell it to the
16 fastener companies in the country and get rich.

17 THE COURT: So would you.

18 MR. MILLER: Pardon me?

19 THE COURT: So would you.

20 MR. MILLER: There is nothing wrong with it,
21 but that is not my contract. I'm not in this business.
22 That is what they are doing. It exists separate and
23 apart, it sure does --

24 THE COURT: Well, you're in the business of
25 selling Business One, right?

1 MR. MILLER: There are lots of fastener
2 companies out there that might do that. There is no
3 express term in the development agreement that makes us
4 an intended third party beneficiary.

5 If you go back and look at *Resource Title*,
6 for example, one of the cases they cite, there are
7 clear benefits that grow directly --

8 THE COURT: There is case law all over the
9 place on third party beneficiaries. I'm sticking to
10 the agency thing.

11 MR. MILLER: And forgive me, but on the
12 agency front, nothing changed. No agency allegations
13 ever change the identity of the parties to the
14 contract. One of the things --

15 THE COURT: But if LSI was acting as your
16 agent, wouldn't you be bound by the contract?

17 MR. MILLER: And that goes back to the point
18 I made before.

19 The first thing I look at in a contract case
20 is what does the language say, because we need to
21 determine the parties' intentions.

22 Well, the language here, there is -- all of
23 this agency stuff aside, it cannot get past the simple
24 clear fact the parties intentions were expressly
25 stated. This was a contract between LSI and Hodell.

1 If it doesn't say that it can't be --

2 THE COURT: But if LSI didn't have your
3 agreement, and I have read that agreement as well, that
4 they can sell Business One software, they wouldn't be
5 executing that contract.

6 MR. MILLER: But they couldn't have done
7 that. If the parties wanted to have a triangular
8 contractual relationship like that, that intention
9 would be clearly expressed in the first sentence and in
10 the signature line. "Look, we're all in this together.
11 Here is what Hodel does, here is what LSI does, here
12 is what SAP does."

13 THE COURT: I have to accept the allegations
14 in the complaint. They are alleging that LSI was your
15 agent. Can I consider LSI's admission to that?

16 MR. MILLER: It stops there. You can assume
17 the agency admission, okay, but my point is that
18 doesn't change the identity of the contract, and there
19 is -- like *Twombly* starts to matter at some point,
20 because they can't say that this --

21 THE COURT: You think *Twombly* changed the law
22 in the Sixth Circuit?

23 MR. MILLER: I think *Twombly* raised the bar
24 a bit for what you have to set forth, you know --

25 THE COURT: The circuits are all over the

1 place on that too, right?

2 MR. MILLER: I know, but my point is either
3 before or after *Twombly*, it has been, is, and probably
4 always will be the case that you can't just say
5 something in the complaint that is contrary to the
6 obvious facts, and they say, "Oh, SAP is a party to
7 this development agreement" --

8 THE COURT: So they are making a legal
9 conclusion?

10 MR. MILLER: It is a legal conclusion that
11 flies in the face of the basic facts that, no, they are
12 not. It is between LSI and Hodell, and they can't do
13 that. You can't just say today is Friday, so that's
14 assumed to be true for purposes of the complaint.
15 Today is Monday.

16 The parties to that contract are Hodell and
17 LSI. They can't change that. And they -- there could
18 be an agency issue, and in this case --

19 THE COURT: So you think SAP knew nothing
20 about the --

21 MR. MILLER: We might have.

22 THE COURT: -- about the clause in that
23 contract that had some performance on your part
24 involved in it, in case LSI folded?

25 MR. MILLER: I think taking their conclusions

1 to where they ought to be, assumed to be true, et
2 cetera, et cetera; they say LSI was our agent. Well,
3 our agent said --

4 THE COURT: But there is something in the
5 contract that would kind of support that.

6 MR. MILLER: Our agent said that if LSI goes
7 under, SAP will sell some -- great, fine, we're bound
8 by that. We're at least stuck in the case with the
9 agency allegation.

10 THE COURT: And that gets you to fraudulent
11 inducement, because your software, we have to presume,
12 could not handle the 80 licenses in the development.

13 MR. MILLER: I take it one step at a time.

14 The first thing, that sentence doesn't change
15 the identities of the parties to the contract --

16 THE COURT: But it implies an agency, doesn't
17 it?

18 MR. MILLER: Pardon me?

19 THE COURT: It implies that LSI may very well
20 be your agent.

21 MR. MILLER: That's true.

22 THE COURT: So it is not just "This is
23 Friday." There is something in the contract that would
24 support the conclusion that they are acting as your
25 agent.

1 MR. MILLER: Them acting as our agent doesn't
2 mean we can be sued for breach of contract. It doesn't
3 make us a party --

4 THE COURT: Well, that's the question, if it
5 makes you liable under the contract.

6 MR. MILLER: But it doesn't. An agency
7 allegation never changes the clear, plain, undeniable
8 identity of the actual parties to the contract.

9 The principal may have problems because his
10 agent is out there in the world doing things he
11 shouldn't do, but it doesn't make the principal liable
12 on contracts if the agent signs in the agent's own
13 name.

14 THE COURT: On a 12(b)(6), the standard is a
15 little different.

16 MR. MILLER: Except, Your Honor --

17 THE COURT: If you had depositions and all
18 those things to go with it --

19 MR. MILLER: I would respectfully submit that
20 is just not right. It cannot -- they cannot take a
21 development agreement that says it is between Party A
22 and Party B, very clearly, signed by Party A, signed by
23 Party B, and then come in to Your Honor and say "Oh,
24 12(b)(6), the Court to has to assume everything we say
25 is true." Either up is down, down is up --

1 THE COURT: But that's what makes the case so
2 confusing, because then you go right back to the whole
3 issue of fraudulent inducement --

4 MR. MILLER: And I'm happy to go there. And
5 I conceded that before, and the answer to that is "And
6 then what?"

7 We entered into -- when we finally got around
8 to selling them the licenses, we entered into a
9 contract that said "Look, wipe it all clean, we're
10 going to" -- here is how -- the damages are limited,
11 and now we're in privity, the economic loss rule
12 applies, and I did check that case, Your Honor, it is a
13 Sixth Circuit case, that *Irwin Seating* case was a
14 motion to dismiss, and it was fraudulent inducement,
15 and it is software --

16 THE COURT: Okay. Mr. Lambert, are you going
17 someplace else?

18 MR. LAMBERT: No. Did you have any other
19 questions for me?

20 THE COURT: I guess I want to at least talk
21 about this 9(b) issue versus the 12(e) issue. You
22 know, you're saying you can't have a 9(b) motion
23 without first filing a 12(e) motion. You know, I'm not
24 sure, Mr. Miller, where you are at on that. You made
25 some comment in chambers about that. Can we not

1 eliminate that, at least, from this process?

2 MR. MILLER: Your Honor, forgive me, I'm not
3 trying to make this case more complex. I think this
4 case is more simple.

5 On the fraud count, it is unclear. They are
6 not -- number one, the standard for punitives is very
7 high. Number two, when you read the cases, whether
8 something in a commercial context is a representation
9 or not is a pretty high standard --

10 THE COURT: It's a pretty simple question.
11 Do you have to ask for a more definite statement in the
12 Sixth Circuit case law before you can ask for a
13 dismissal under 9(b)?

14 MR. MILLER: I'm not certain of the answer to
15 that.

16 THE COURT: Okay. That is my question.

17 MR. KOEHLER: I worked on the *Resource Title*
18 case, I didn't read that. That was a defense raised to
19 our complaint. I didn't raise it. Judge Wells raised
20 it on her own, so I wasn't aware of it before that.
21 But as far as I can tell, that's the standard in the
22 Sixth Circuit, especially in the Northern District.

23 THE COURT: That's my understanding as well.
24 You didn't read his brief, then?

25 MR. MILLER: Well --

1 MR. LAMBERT: In response to that part of it.

2 MR. MILLER: Well, frankly, Your Honor, I
3 don't -- I don't see why, if under 9(b) -- under
4 Rule 9, they have to be specific in the context of a
5 motion to dismiss. They can't fail to state a claim
6 due to lack of specificity, and that's my point. They
7 failed to state a claim under 12(b)(6) because they
8 violated Rule 9, and when you read their
9 representations, it is not clear --

10 THE COURT: I get the merits of what you are
11 saying on the 9(b). It is a question of procedurally
12 are we there yet.

13 MR. MILLER: Right. As I just mentioned,
14 there is not a lot of that in the briefs. There is --
15 it has actually come up from reading all these cases,
16 preparing for this argument. There is a real test
17 under Ohio law for whether something, like the Business
18 One profile sheet, and the white paper, a lot of that
19 is puffery. It doesn't even constitute a
20 representation in a commercial context, and they don't
21 say when you read the complaint who said what, and it
22 is difficult to tell.

23 THE COURT: One thing I would like you to
24 help me with is in fraudulent inducement, privity
25 versus non-privity. I'm hearing you say there is such

1 a thing as fraudulent inducement without a contract?

2 MR. MILLER: Yes.

3 THE COURT: And that would be the purchase of
4 goods, like we're talking about in the *Magical Farms*
5 case. There is no contract there.

6 MR. MILLER: I think fraudulent inducement,
7 the analogy, Your Honor, that you brought up before is
8 probably pretty good, where I induced -- Party C
9 induces A and B to enter into a contract and says all
10 sorts of things to A and B to induce them to do that,
11 but Party C enjoys some sort of indirect benefit from
12 that contract, so there can be fraudulent inducement --

13 THE COURT: But Party C was the one making
14 the fraudulent representations.

15 MR. MILLER: Right.

16 THE COURT: So, I mean, that's the point of
17 this. Not only did you get a benefit, but you are the
18 one that put out the paper and made the representations
19 that you could handle this. So, it is more than just
20 getting a benefit. You made the representations.

21 MR. MILLER: That's my analogy. I'm
22 conceding that. We're Party C. A is Hodell; B is LSI,
23 and Party C is making representations that induce them
24 to enter into their contract, and indirectly we get to
25 stand around and wait for licenses to get sold, and

1 maybe they take off --

2 THE COURT: That's your benefit.

3 MR. MILLER: Pardon me?

4 THE COURT: That's your benefit.

5 MR. MILLER: It is a benefit, and that's
6 where I think you could have a fraudulent inducement
7 count in the absence of a contract. However, that's
8 not our case. We have a contract. It is a license
9 agreement --

10 THE COURT: But again, that is presuming that
11 the license agreement, you know, is the total agreement
12 between you and --

13 MR. MILLER: The presumption is based on the
14 language that we included in the contract --

15 THE COURT: But let's say there wasn't a
16 license agreement.

17 MR. MILLER: Right.

18 THE COURT: They never got to the point of
19 actually buying the license.

20 MR. MILLER: We have a tougher economic loss
21 rule argument, then.

22 THE COURT: Well, but you have a fraudulent
23 inducement argument as well, don't you? You had a bad
24 fraudulent inducement argument, right?

25 MR. MILLER: Well, I think --

1 THE COURT: So I'm trying to figure out what
2 the privity issue is that saves you here.

3 MR. MILLER: It goes like this: Forget --
4 like Your Honor says, forget the license agreement, act
5 like it never existed.

6 THE COURT: Right. Yes. Let's do that for a
7 second.

8 MR. MILLER: Just the development agreement.

9 We would have a harder time raising the
10 economic loss rule as a basis for their fraudulent
11 inducement claim being dismissed because the fact is
12 under Ohio law, when there is no privity, it is tougher
13 to raise the economic loss rule and get --

14 THE COURT: So they get the proximate
15 damages.

16 MR. MILLER: I'm not sure that we lose,
17 because there is still that damages requirement under
18 the Ohio law, and it is very unclear, because some of
19 those are fraudulent inducement cases, but the ones I
20 have cited -- the first thing is *Whirlpool*, and I have
21 a copy of it, it is cited in the brief. The *Whirlpool*
22 case says when there is privity in a commercial
23 context, the economic loss rule is applied more
24 strictly, and when you read the cases, that's what they
25 do, and they definitely pay close attention to whether

1 there is privity --

2 THE COURT: So we're right back again -- I'm
3 going to need you guys to help me more on the issue of
4 the relationship between the license agreement and the
5 development agreement, because that's where -- we're
6 right back to then again with what you are saying.

7 MR. MILLER: And, Your Honor, all I can tell
8 you is --

9 THE COURT: That's the privity that you're
10 referring to, is the licensing agreement.

11 MR. MILLER: Yes. Absolutely. And to me,
12 fine, 12(b)(6), all their allegations are taken to be
13 true, et cetera, et cetera, but they can't call today
14 Friday, and they can't deny that they have a license
15 agreement with us, and they agree to its terms, and the
16 terms say this is the sole and exclusive agreement
17 between us and you. Everything else is wiped clean.

18 Okay. So when I'm doing economic loss rule
19 analysis, first question, privity or no, absolutely
20 privity. License agreement. Okay. Economic loss rule
21 is applied more strictly. Is it applied so strictly
22 that I can get a fraudulent inducement count kicked on
23 a 12(b) -- at the 12(b)(6) stage, that early? Answer:
24 Yes, if a fair reading of the complaint is they
25 basically took the preach of contract case and breach

1 of contract damages, and they are trying to make it
2 sound like a tort case.

3 So, you read their complaint carefully. The
4 first paragraph says we're basically suing because the
5 stuff didn't work. Everything else they say is the
6 same, and they say they want two things, indirect
7 damages and direct damages, and they want that for
8 contract --

9 THE COURT: But don't you have a duty outside
10 the contractual duty not to act fraudulently with
11 Hodell? That's the whole point here, isn't it?

12 MR. MILLER: The jurisdictions are splat --

13 THE COURT: You don't need the duty under the
14 contract to prove the fraudulent misrepresentation
15 count.

16 MR. MILLER: It is unclear. The
17 jurisdictions are split on it.

18 THE COURT: But Ohio is not, is it?

19 MR. MILLER: Ohio is not clear. There is no
20 Ohio Supreme Court case that says in the fraudulent
21 inducement context that you have a separate duty apart
22 from the contract to do this.

23 And you will remember, I conceded that that's
24 the tougher argument of those two elements, the
25 separate duty. It's the tougher one for us.

1 THE COURT: Yes. I don't want to beat a dead
2 horse --

3 MR. MILLER: I understand, but this is
4 interesting. You read *Galmish*, and when I'm reading
5 *Galmish*, I'm expecting that issue to come up. *Galmish*
6 is about parol evidence, it is a fraudulent inducement
7 case, looks likes they are in privity. Okay. Ohio
8 Supreme Court. They are going to say it. And they
9 never do, and I find myself scratching my head.

10 Maybe the lawyers never raised economic loss
11 rule. It doesn't look like they did. I don't know
12 what the answer is, but it is clear under Ohio law they
13 have to satisfy both requirements, duty and damages,
14 and when you look at the damages here, you read their
15 complaint, it is breach of contract, and you look at
16 the case, that *Irwin Seating* case, Sixth Circuit,
17 motion to dismiss, the Sixth Circuit says "We read the
18 complaint, dismissed. Fraudulent inducement is out.
19 This complaint is really a breach of contract case, and
20 you can tell because you look at the kind of damages
21 they are looking for," and that is what is happening
22 here.

23 THE COURT: Okay. Let me go through the
24 motion to dismiss a little here.

25 Can we treat your two clients the same here?

1 I know you made some distinctions between them in the
2 motion to dismiss.

3 MR. MILLER: You mean between SAP America and
4 SAPAG? Absolutely not.

5 THE COURT: Tell me the difference, then.

6 MR. MILLER: Well, SAP America, first of all,
7 is a subsidiary of SAPAG, but they are separate and
8 distinct corporate entities. SAP America is party to
9 the license agreement, and SAPAG is not.

10 THE COURT: But SAPAG is the one that made
11 the representations.

12 MR. MILLER: They allege, they have
13 effectively an allegation -- it goes back to my
14 definitive --

15 THE COURT: I know, but for the fraudulent
16 inducement, for accepting what they are saying in the
17 12(b)(6), SAPAG is where the representations came from,
18 right, as to Business One capabilities?

19 MR. MILLER: I don't think so.

20 THE COURT: I think that's what the complaint
21 alleges, but maybe -- well, I'll ask --

22 MR. MILLER: I think have very conclusory
23 allegations, almost like an alter ego statement, that
24 everybody did everything on behalf of everybody else,
25 and ignore the corporate distinctions.

1 THE COURT: Well, I don't know about that,
2 but at least we have to take the allegations in the
3 complaint as true, right?

4 MR. MILLER: And they never -- and here is
5 what they do. They say that SAP and SAPAG are
6 basically the same thing, and then they collectively
7 refer to them and they have all these representations,
8 and they never say which one of them did it, and one of
9 my points on a more definitive statement is, "Look, if
10 you are going to try to" --

11 THE COURT: But Business One belonged to
12 SAPAG, not SAP America. It belonged to SAPAG. They
13 are the ones that bought the Israeli company that had
14 the software in the first place.

15 MR. MILLER: And the right to sell the
16 license was SAP America. The history of it --

17 THE COURT: But they marketed it all over the
18 world with the same --

19 MR. MILLER: They may have been issuing some
20 of those papers, but the license agreement is
21 between us --

22 THE COURT: Okay.

23 MR. MILLER: And I'm not --

24 THE COURT: I understand the license
25 agreement --

1 MR. MILLER: No, I understand, and I would
2 like Your Honor to know --

3 THE COURT: I'm talking about the tort
4 claims.

5 MR. MILLER: I'm not trying to be too
6 argumentative --

7 THE COURT: No, I understand. That's what
8 they are here for.

9 MR. MILLER: There is a sentence in the
10 complaint that is early on, they say, "Look, each one
11 is the same," and then you read the rest of the
12 representations and you are cannot tell which one they
13 are saying is making those, and frankly, I don't know,
14 and I would like to --

15 THE COURT: Okay.

16 MR. MILLER: If SAPAG is not out of the case,
17 I would like them to be more clear about what they are
18 saying we did.

19 THE COURT: Mr. Lambert.

20 MR. LAMBERT: I think the precise reason you
21 cannot specify the distinction between the two is that
22 in our client's mind, the way it was marketed and sold
23 to us, there wasn't one. So if an employee of the
24 SAPAG or SAP America, if they don't identify who they
25 are speaking on behalf of, how is Hodell-Natco supposed

1 to know? And in turn, how are they supposed to allege
2 it?

3 And there is case law, especially with regard
4 to 9(b), and I think we've been very specific in our
5 complaint, and in some instances more so than we're
6 obligated to be --

7 THE COURT: Honestly, we believe that the law
8 in this circuit is that you've got to make the 12
9 motion before you can make the 9 motion.

10 MR. MILLER: Understood.

11 THE COURT: So we'll be past that.

12 MR. MILLER: We may be dealing with that
13 later, then. I understand.

14 THE COURT: So the question is, from your --
15 for the 2(b) motion to dismiss, set aside the 9 issue,
16 are we still treating your two clients differently,
17 based on the allegations in the complaint?

18 MR. LAMBERT: I'm sorry. What was the
19 question, Your Honor?

20 THE COURT: I put the question back to him.
21 Setting aside the 9(b) issue, and the specificity of
22 the pleadings, the question is if we accept the
23 pleadings as being specific enough, does that eliminate
24 the distinction between SAP and SAPAG -- SAP America
25 and SAPAG on the tort claims?

1 MR. MILLER: Understood. I would have to
2 look at the complaint more carefully, but my standing
3 here understanding is that they have allegations in
4 here that these guys are the same, and they all said
5 this, and if that's true, then that's what they have in
6 their complaint.

7 MR. LAMBERT: And if you look at Exhibit A to
8 our complaint for example, Your Honor, it is an SAPAG
9 document. Exhibit A --

10 THE COURT: That was my question. Weren't
11 they making the representations on a worldwide basis?

12 MR. LAMBERT: It is the Business One brief
13 that is referred to throughout the complaint.

14 THE COURT: I'm just looking for concessions.

15 MR. MILLER: I understand.

16 THE COURT: Make my job easier.

17 MR. MILLER: I understand, and I'm being
18 completely honest.

19 THE COURT: That's fine.

20 MR. MILLER: My recollection is they cast a
21 very wide net, and if they are allowed to plead that
22 way --

23 THE COURT: Well, I don't know, but
24 procedurally, I don't think that we're at the motion to
25 dismiss on the other thing.

1 Ohio law and parol evidence on fraudulent
2 inducement --

3 MR. MILLER: *Galmish*. They basically argue
4 under *Galmish* --

5 THE COURT: You argued the Pennsylvania
6 exceptions, which did not include fraudulent
7 inducement. Your argument was there was no fraud in
8 the execution and no proof that you ever intended to --

9 MR. MILLER: Number one --

10 THE COURT: So now it is a different
11 question. No fraud in the execution is not the issue.

12 MR. MILLER: I think that's fair to say. I
13 don't think there has ever been an allegation that we
14 kind of tricked them and put words in there that nobody
15 saw.

16 THE COURT: So the question is under Ohio
17 law, parol evidence and fraudulent inducement --

18 MR. MILLER: And their argument, *Galmish*,
19 there is a phrase in *Galmish* that says if statements
20 are consistent with what is in the contract, then you
21 can have fraudulent inducement, and that is their
22 argument, and I understand it and I have not dwelled on
23 it --

24 THE COURT: It is all about the number of
25 users, and again, you knew there was going to be 120.

1 MR. MILLER: Effectively they are saying we
2 said there are -- you can use -- we have lots of
3 conversations with them where we said users is no
4 problem, and in the contract we said users is no
5 problem, and according to *Galmish*, if what you said
6 before was consistent with what is in the agreement,
7 that can support a fraudulent inducement count.

8 If you stop the Ohio Supreme Court and took a
9 poll and ask them, oh, when you dropped the word
10 consistent if there did you mean to blow this all up, I
11 don't know what they would say, but *Galmish* has
12 language in it that Hodell has seized on, and I
13 understand it.

14 THE COURT: But no question that you knew
15 that they were buying 120 licenses by the time the
16 licensing agreement was signed, right? We've
17 established that.

18 MR. MILLER: As I point out, we say it will
19 work for you. If they bought a thousand, we would be
20 saying it would work for you.

21 THE COURT: Right. The gist of the action
22 rule -- do you want to add anything to the issue about
23 SAP/SAP America/SAPAG?

24 MR. LAMBERT: No. Only that it is
25 sufficiently alleged in the complaint. The specificity

1 argument, A, is procedurally improper, but B, I think
2 our complaint is more than -- more than specific. The
3 exhibits can be referenced as part of the specificity
4 requirement, and if, for example, Exhibit A, which is a
5 SAPAG document --

6 THE COURT: And what about the parole evidence
7 law and the Ohio rule on fraudulent inducement?

8 MR. LAMBERT: *Galmish* is obviously directly
9 on point.

10 THE COURT: You are both arguing *Galmish*?

11 MR. LAMBERT: He is not arguing it. I think
12 he is conceding it.

13 MR. MILLER: I don't really like *Galmish*. It
14 is interesting, as I pointed out before, why economic
15 loss was never raised in *Galmish* is a mystery to me.

16 THE COURT: We're talking about parole
17 evidence. So you're conceding that issue, then, in
18 Ohio law?

19 MR. MILLER: What?

20 THE COURT: That they can use parole evidence
21 to prove fraudulent inducement.

22 MR. MILLER: I'm not prepared to concede it
23 under Ohio law because I don't think it is right, but I
24 do concede that *Galmish* has language in it that is very
25 unfavorable to SAP because it says that you can proceed

1 with a fraudulent inducement claim if what you said in
2 advance of the contract is consistent with what's in
3 the contract.

4 I don't know if you polled the Ohio Supreme
5 Court that they would say, "Oh, that's what we meant,
6 you are allowed to do, you know, what you are doing in
7 the Hodell case."

8 THE COURT: That's close to a concession.

9 Let's talk about gist of the action a minute
10 here.

11 MR. MILLER: I may be able to save us some
12 time on that, Your Honor. That is primarily a
13 Pennsylvania doctrine. In Ohio, it is basically
14 absorbed in the two step duty on damages piece.

15 THE COURT: So we're taking the gist of the
16 action argument off the table?

17 MR. MILLER: When I took Pennsylvania off the
18 table, yes.

19 THE COURT: Thank you.

20 MR. MILLER: There you go.

21 THE COURT: You are my hero now.

22 All right. Economic loss rule. As I
23 understand the plaintiff's argument is saying Ohio law,
24 the economic rule, economic loss rule is inapplicable
25 because the defendant had a duty to refrain from making

1 fraudulent or negligent representations --

2 MR. LAMBERT: Yes. In fact, I think that's
3 precisely why the economic loss doctrine was not raised
4 in *Galmish* with regard to the fraudulent inducement
5 claim, because it is not a defense to a fraudulent
6 inducement claim. Fraudulent inducement is an
7 intentional tort.

8 The Supreme Court, when it formulated the
9 economic loss doctrine or adopted it, applied it with
10 regard to negligence claims. They are claiming
11 negligence with regard to pure economic damages.

12 And before I forget --

13 THE COURT: We're going to get to the
14 negligence count before we conclude today.

15 MR. LAMBERT: We might have a problem with
16 the negligence count. I would submit that I should be
17 allowed be permitted to conduct discovery on it, but I
18 understand where the Court is coming from.

19 THE COURT: Because if your argument on the
20 economic loss rule regarding your fraud claims, that
21 Ohio has held that a duty lies independent of the
22 contract to refrain from negligently supplying
23 information to one who justifiably relies upon it, you
24 know, I want to talk in a minute about the -- whether
25 there is an independent duty in negligence outside the

1 contract, as opposed to fraudulent representations or
2 negligent representations, but I want to ask Mr. Miller
3 to respond the economic loss rule and Ohio law in
4 regard to the fraud claims and the negligent
5 representation claims.

6 MR. MILLER: Sure. Negligence I thought it
7 might be Mr. Lambert's term to concede.

8 THE COURT: I'm going to get back to him on
9 that. I'm talking about the negligent representation,
10 not the negligence.

11 MR. MILLER: Understood. Very limited types
12 of cases, where there is some sort of -- most of them
13 are not privity cases, and they involve professionals,
14 accountants, right? The *Hadden* case --

15 THE COURT: Professional malpractice.

16 MR. MILLER: Right. And to me, it is -- it
17 can be simplified. Because if the economic loss rule
18 applies to fraudulent inducement, the economic loss
19 rule certainly applies to negligent misrepresentation
20 counts.

21 If Your Honor determined that the economic
22 loss rule didn't apply to fraudulent inducement, and
23 you are looking at negligent misrepresentation counts,
24 when you read the complaint, they are essentially same
25 saying the same thing, and all I would argue is that

1 the cases under Ohio law appear to be limiting the
2 application of the economic loss rule -- the decision
3 not to apply the economic loss rule to these cases
4 where there is some sort of professional relationship,
5 and I don't think we had that.

6 THE COURT: But that is not implicit in the
7 decisions. That's just the facts of the cases that it
8 ruled on is what you're suggesting.

9 MR. MILLER: You know, there is some language
10 in there that these were professionals and were in the
11 business --

12 THE COURT: Why would that be?

13 MR. MILLER: Pardon me?

14 THE COURT: Why would that be? Why?

15 MR. MILLER: Think about the legal
16 malpractice. It is a strange animal.

17 I hire a lawyer, the guy screws up my case, I
18 want to sue, it is a tort. Like medical malpractice.

19 THE COURT: Yes, but you're just talking
20 about a duty not to act fraudulently, right, and
21 economic loss.

22 MR. MILLER: But if my plumber puts my water
23 heater in and he screws it up in kind of the same way,
24 both were not paying attention or whatever, I just have
25 a contract against the plumber. So there is --

1 THE COURT: But that is negligence, isn't it?

2 MR. MILLER: Against the plumber? No.

3 THE COURT: Your professional standards.

4 MR. MILLER: That is my point. You asked
5 isn't that weird, why would that be, and my point is
6 there has been this law in many jurisdictions, going
7 back many, many years, there is an exception where some
8 professional owes you a duty, even though you
9 definitely have a contract with your doctor, you have a
10 contract --

11 THE COURT: Okay, but here is where my point
12 is. When your lawyer owes you a duty and is negligent
13 in performing, that is a negligence complaint --

14 MR. MILLER: True.

15 THE COURT: -- not a fraud complaint. So,
16 you know, that goes back to where I'm going to go back
17 to them, with the negligence issue. That argument, I
18 think, plays very well into it. But when it is fraud,
19 or, you know, something higher than negligence itself,
20 like a negligent representation, why wouldn't the
21 economic loss rule go away under Ohio law? Because
22 your professional standards is a negligence issue.

23 MR. MILLER: It may or may not.

24 THE COURT: Okay.

25 MR. MILLER: And on duty, I concede it is a

1 tougher argument for SAP --

2 THE COURT: You have already done that.

3 MR. MILLER: Okay. But however, the economic
4 loss rule under Ohio law has two requirements, and it
5 can be fraudulent inducement or negligent
6 misrepresentation, or any type of tort. If the damages
7 are the same, that's it. And you had a contract with
8 the people, and the damages you want for your torts are
9 the same as the contract damages. Done.

10 THE COURT: They are not, though.

11 MR. MILLER: They are.

12 THE COURT: No. You wanted limited damages
13 to your licensing agreement.

14 MR. MILLER: Well, the -- then you could
15 always sue in Court if there is a damages limitation.
16 The point is, in the cases --

17 THE COURT: If it is fraudulently induced.

18 MR. MILLER: The cases analysis is what does
19 the law give you for breach of contract, and if the
20 scope of that is the same, you can't get --

21 THE COURT: Okay. But the question is you
22 still want to argue economic loss rule on the tort
23 claims other than negligence.

24 MR. MILLER: Okay.

25 THE COURT: Thanks. Negligence.

1 MR. MILLER: Well, as to negligence also.

2 THE COURT: Yes, of course. Right.

3 Including negligence. Negligence, can we make that one
4 go away?

5 MR. LAMBERT: For the record, I just want to
6 state that I think that Hodell-Natco is entitled to
7 conduct discovery, because also, the economic loss
8 doctrine doesn't apply to non-economic damages, so to
9 conduct, to proceed in discovery on the nature --

10 THE COURT: But you have already -- you
11 said -- it would be interesting to see it in the brief.
12 You said that you alleged property damage, and I was
13 kind of going to press you on that. Show me in the
14 complaint where you have alleged property damages.

15 MR. LAMBERT: I don't think I can sit up here
16 and prove that we have sustained property damage, and I
17 think it is a tough argument to make.

18 THE COURT: So you are conceding that you
19 have not alleged property damage, then?

20 MR. LAMBERT: I think we have alleged --

21 THE COURT: You say in your brief you did.
22 But I read the complaint twice. I was trying to figure
23 out where that was at.

24 MR. LAMBERT: Correct. You can construe
25 damage to the information systems, if damage was

1 sustained to the information systems, the Hodell
2 internal IT structure.

3 THE COURT: You didn't allege that, I don't
4 think.

5 MR. LAMBERT: I don't know whether they
6 allege it specifically. Whether you could prove it
7 through discovery or not is a different animal.

8 THE COURT: So you are saying the negligence
9 count survives only on the property damage issue?

10 MR. LAMBERT: If the Court finds we have
11 alleged property damage, then --

12 THE COURT: Are you conceding that the
13 negligence count survives only on the property damage,
14 and the economic loss rule knocks out the pure
15 negligence count?

16 MR. LAMBERT: Pure negligence, yes; negligent
17 misrepresentation, no.

18 THE COURT: What can I take away from what
19 you just said, Mr. Lambert? I can say to the extent
20 there is property damage, the negligence count has a
21 life; to the extent there is no property damage alleged
22 in the complaint, it has no life?

23 MR. LAMBERT: Correct.

24 THE COURT: That's fair. Okay.

25 Let me look at my breach of contract here.

1 Mr. Miller, is there an implied warranty in
2 the development agreement at all?

3 MR. MILLER: I'm not sure, Your Honor.

4 THE COURT: Okay. Just not yours?

5 MR. MILLER: Pardon?

6 THE COURT: Just not yours if there is one?

7 MR. MILLER: That's right.

8 THE COURT: Okay. Any concessions we can
9 make on the damages asked for, the punitives, in regard
10 to 12(b)(6) versus summary judgment?

11 MR. MILLER: Your Honor, I've read more of
12 the punitive damages cases after the briefing than
13 before, including the case this morning. It seems to
14 suggest to me that there ought to be a pleadings
15 standard. Since collecting them is that high, you
16 ought not to be able to just get them by saying you get
17 them. When you read these complaints, none of it
18 sounds like -- if everything in there is true, it
19 doesn't sound like they get punitive damages.

20 THE COURT: All right. Any summation?

21 MR. MILLER: Your Honor --

22 THE COURT: You're done? You've had enough?

23 MR. MILLER: Well, I will say this. I have a
24 copy of the Power Point --

25 THE COURT: I would like that.

1 MR. MILLER: And this is it. It has all the
2 cases cited in there.

3 THE COURT: I guess you guys could help me,
4 as I said, with the relationship between the two
5 contracts -- we'll take that as well. Sure.

6 MR. MILLER: Thank you. My apologies. I
7 thought it would actually make it easier.

8 THE COURT: We need a thicker book from you,
9 Mr. Miller. Is that what you are saying?

10 Is there any additional help you can give us,
11 citing, you know, you say there is no case law on the
12 issue of the relationship between the licensing
13 agreement and the development agreement, yet you are
14 both on opposite sides of whether one exists without
15 the other.

16 Is there some case law you can provide the
17 Court in short order that would help me with it, either
18 side?

19 MR. MILLER: I will be happy to look, and if
20 we find something, Your Honor, that we believe will
21 assist, I'll submit it.

22 THE COURT: I want to get this ruling out for
23 you guys as soon as I can.

24 MR. MILLER: I have some -- what's the
25 word -- disability. I'm supposed to go on vacation

1 this afternoon, which I think is going to be fine, but
2 the gentleman I work with is also on vacation. I can
3 get some help from someone, and if we find something
4 that changes this, we would submit it.

5 I would say, Your Honor --

6 THE COURT: Mr. Zepp, you are going on
7 vacation.

8 MR. ZEPP: I'm not going on vacation. I
9 already had mine this summer.

10 THE COURT: Seems to me it is a pretty basic
11 point, and you both say it is a no-brainer --

12 MR. MILLER: I get that, and all I can do is
13 hopefully not repeat myself verbatim, but I don't think
14 you're going to find cases, because I think -- two
15 things: One, these are simple, basic, black letter
16 law. Like we were talking about, law school
17 propositions.

18 Number two, when applied, there are very
19 complex fact patterns, and you have to look, you have
20 the development agreement between these two parties,
21 they want to kind of get this thing up and running, get
22 this SAP software, go into business together, et
23 cetera, and there is one phrase that jumped out at me
24 when I was listening to counsel for Hodell. They said
25 -- well, I'll summarize it. They want discovery to

1 determine that the parties to the development agreement
2 aren't as they appear. And you don't get discovery to
3 determine if you have a cause of action. They don't
4 have a breach of contract action because there is
5 nothing on the face of the earth that can controvert
6 the obvious intentions of LSI and Hodell when they
7 entered into the development agreement.

8 THE COURT: But if they can make the
9 fraudulent -- you know, I'm not going to go back to the
10 fraudulent --

11 MR. MILLER: Then you're into the fraudulent
12 tort claims.

13 THE COURT: Then they get their whole damages
14 and they don't need the breach of contract, right?

15 MR. MILLER: Well, and then they are going to
16 have to deal with did they have that when they signed
17 the license agreement with us that has its terms.

18 THE COURT: Okay. Look. Mr. Lambert, is
19 there any help you can give me on the relationship
20 between those contracts, in short order? Like end of
21 this week?

22 MR. LAMBERT: I spent a lot of late nights
23 putting that brief together, and I never found any. I
24 am not aware of anything that is going to illuminate
25 the relationship between --

1 THE COURT: But I don't think you guys really
2 addressed -- you know, I read the briefs. I'm not sure
3 we addressed that point in the briefs. Your complaint
4 certainly does, and you said if the licensing agreement
5 is valid, it was fraudulently induced, but the impact
6 that it might have had on the -- maybe I missed that,
7 but --

8 MR. LAMBERT: Throughout the brief, my point
9 was that there was two separate transactions in 2004
10 and 2005. What the license agreement says or limits,
11 even if it is not fraudulently induced, even if it is
12 fully enforceable, can't apply to what occurred in
13 2004, a year earlier, and that is my point.

14 I don't think there is any argument that a
15 contract was formed in 2004 and a contract was formed
16 in 2005. There is disagreement as to who the parties
17 are. We have factual and legal arguments as to why SAP
18 is a party to the sale, the purchase and sale of SAP
19 Business One in 2004, okay?

20 They sold licenses to us in 2004 through LSI;
21 we paid a purchase price for those licenses in 2004
22 through LSI through to SAP. That is sufficient to form
23 a contract with SAP if LSI is their agent.

24 So, with who is a party to the development
25 agreement, SAP is not mentioned as a party; I don't

1 know that you really even need to go there. But
2 certainly, the development agreement confers
3 obligations upon SAP to sell us the software if LSI
4 can't at some point, to deliver the remainder of the
5 software. It would obviously in that circumstance
6 obligate us to pay for it, so I don't see how SAP can
7 argue that they have no relationship to this
8 transaction in 2004 whatsoever.

9 MR. MILLER: Your Honor, I am not highly
10 confident that we'll find any cases, but I am going to
11 look.

12 THE COURT: I appreciate it.

13 MR. MILLER: If we find something
14 instructive, we'll forward it to Your Honor, and we'll
15 do it within a couple days.

16 THE COURT: That would be great, and if you
17 could do the same, Mr. Lambert, I appreciate it.

18 I hear what you just said, but I'm not sure
19 that really answered the question of what impact the
20 license agreement, if it wasn't fraudulently induced,
21 had on the development agreement in respect to SAP's
22 liabilities. So, I'm not sure you just answered that,
23 but --

24 MR. LAMBERT: Well, it goes back to one of
25 the things I said at the outset.

1 The license agreement but its terms doesn't
2 apply to previous software. It applies to -- the
3 definition of the term "software" in that agreement, it
4 says it applies to the present and future purchases.
5 And construing that agreement against the drafter, had
6 they wanted it to apply to that prior contract, they
7 should have put that in there, or they should have
8 dated it retroactively. You don't get just there by
9 throwing in a general merger clause that doesn't make
10 it applicable to a prior purchase and sale. The
11 integration doctrine is not that broad.

12 THE COURT: Anything else from counsel?

13 MR. MILLER: No, Your Honor.

14 MR. LAMBERT: No. Thank you, Your Honor.

15 MR. KOEHLER: I would only add, Your Honor,
16 and I have not done the briefing and so I'm not
17 anywhere near as conversant with the cases, but the
18 issue that you are focused on is a very critical issue
19 in the case.

20 THE COURT: That's why I'm trying to get an
21 answer.

22 MR. KOEHLER: I don't see how it could fairly
23 or properly under the law be resolved at this stage.
24 It's a complicated transaction, multiple parties
25 involved; the license agreement does not make any

1 specific reference to that development agreement, so
2 how it can be resolved in a 12(b)(6) stage, a final
3 legal determination made as to the impact of one of
4 those agreements upon the other, I don't think it can
5 be properly done at this stage of the proceedings.
6 That's all I have to add.

7 MR. MILLER: Your Honor, I'll respond, if you
8 will permit me, very briefly.

9 THE COURT: This has been an unconventional
10 argument thus far. We might as well finish it off that
11 way.

12 MR. MILLER: If we can't resolve stuff like
13 this at 12(b)(6), we'll have a hard time clearing
14 dockets of cases. There is a contract here. That
15 development agreement is clear, and what they
16 effectively want to say is throw what is perfectly
17 obvious out the window, unleash us on these folks with
18 discovery -- it was five years ago, six years ago.
19 They have not come up with anything yet. Turn that
20 upside down and chase us in discovery, because they
21 don't like the terms of the agreement they actually did
22 sign.

23 THE COURT: Well, there hasn't been any
24 discovery, has thee? This case has been pending for
25 over a year.

1 MR. MILLER: You're right. They waited years
2 to file it, and it has been --

3 THE COURT: And I'm going to move that.

4 MR. MILLER: I understand that. I understand
5 that. My point is, if the identity of the parties to a
6 contract can't be resolved in a 12(b)(6), then nothing
7 can.

8 THE COURT: Identity of parties versus
9 liability under is a different issue?

10 MR. MILLER: Well, then you go to third party
11 beneficiary, and you have to read. Could we have sued
12 if Hodell didn't do it, and the answer is no. You read
13 *Resource Title*, and not only that, not only were we not
14 an intended third party beneficiary, but this is not
15 like that coal case, or that husband and wife case, or
16 anything like that.

17 THE COURT: Mr. McLaughlin, you have been
18 very quiet over there, sir. Anything you want to --

19 MR. McLAUGHLIN: No. Thank you, Your Honor.
20 Thank you very much. It has been illuminating.

21 MR. MILLER: Your Honor, if we find
22 additional case law, and I will look --

23 THE COURT: I appreciate that.

24 MR. MILLER: I will forward it to you.

25 THE COURT: Look, I had a lot of questions.

1 I appreciate counsel's tolerance of my questions, and I
2 appreciate how well prepared everyone was to make this
3 argument this morning. So, we'll try to get this out
4 as soon as possible. We stand adjourned.

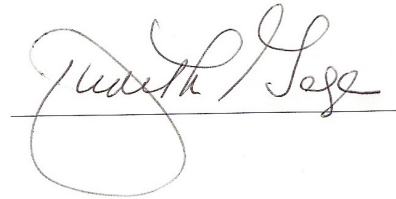
5 (Proceedings adjourned at 11:22 AM.)

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7 C E R T I F I C A T E

8
9 I, Judith A. Gage, Federal Official Court
10 Reporter, certify that the foregoing is a correct
11 transcript from the record of proceedings in the above
12 entitled matter.

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A handwritten signature in cursive script, reading "Judith A. Gage", is written over a horizontal line.

August 18, 2010